BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE NEBRASKA PUBLIC SERVICE COMMISSION, ON ITS OWN MOTION, SEEKING TO ESTABLISH A LONG-TERM UNIVERSAL SERVICE FUNDING MECHANISM

Application No. NUSF-26

QWEST CORPORATION'S POST-HEARING COMMENTS AND BRIEF

The Nebraska Public Service Commission ("Commission") entered Progression Order No. 5 (the "Order") in the above-captioned docket on June 29, 2004, received comments and pre-filed testimony, and held a hearing on August 25 and 26, 2004 to receive testimony on the issues raised in the Order. After the hearing, the Commission requested post-hearing briefs in Procedural Orders Nos. 3 and 4. Qwest's Post-Hearing Comments and Brief follows:

Introduction

Qwest will confine its post-hearing comments to a few focused issues. Qwest still believes all of the proposals, suggestions, and comments it has offered in these proceedings should be adopted by the Commission, and incorporates by reference all prior testimony and comments filed with the Commission.

With that said, Qwest believes the Commission should pay particular attention to four concepts as it considers the comments, testimony, and evidence in this proceeding:

- Where possible, keep the distribution of NUSF support simple.
- 2. Make the distribution of NUSF support predictable.

- 3. Ease adverse impacts on carriers losing significant support.
- 4. When porting support to CLECs, use the same measure of support for both CLECs and ILECs.

These concepts run through most of Qwest's comments below. It is particularly important to recognize these issues relative to Qwest, because Qwest would lose almost twenty million dollars per year in NUSF support under the model. Even small differences in the proposed model could impact Qwest and its customers by hundreds of thousands of dollars, which greatly impacts the ability of Qwest to serve its high-cost customers at current prices for service and access.

Unnecessary Complication In The Proposed Model Makes It Unreliable.

 The Proposed Model Is Faulty Because It Uses Two Different Measures of Density.

As noted in the comments and testimony from Qwest and its witness Peter Copeland, the proposed model measures density in two steps, using two different sources. First, the proposed approach uses the BCPM model to develop the relationship between densities and costs, and the location of households, within wire centers. This occurs in Step 1 as outlined in the prefiled testimony of Tyler Frost. Then, a regression analysis is performed on the BCPM data, which determines a relationship between densities and costs. The regression analysis performed on the BCPM data is then applied to census data in Step 4. The simplest method for distributing support would have been to use either the BCPM data or the census data in both steps 1 and 4. However, the proposed model uses different data sources.

Mr. Copeland explained the impact of using the two different sources of density. First, as Dr. Rosenbaum allowed, the BCPM model excludes certain grids within wire centers when determining density, because the model determines that no facilities would exist in those grids. The census data include all areas within the wire center and do not exclude areas where no facilities do or would exist. As a result, assuming both models find the same number of households and use the same wire center boundaries, distribution of support under Step 4 is often based on lower densities than those used to determine costs in Step 1, as Mr. Copeland's analysis showed:

I looked at 40 wire centers, tried to cover every company that receives support, and compared the square miles in the wire center -- in the total wire center that BCPM would calculate based on excluding those carrier serving -- or those grids where there were no population and no plant placed, versus the square miles that the staff used in its support area, plus the out-of-town and in-town support areas for the wire center and compared those. Also compared the household density from BCPM for those wire centers versus the staff's. And what I found was that *in 34 of the 40 wire centers, BCPM had fewer square miles in the area than the staff*.³

This difference in density wouldn't be important if the differences affected all companies equally. They don't. Mr. Copeland further determined that "there was an unequal reduction in density . . . overall for the independent companies versus Qwest, which would cause a skewing of the Fund allocation." In other words, using the two different measures of density not only causes unnecessary complication in determining support and results in lower densities for determining support than for determining

¹ Rosenbaum at 140; Copeland at 191-192. References to the transcript of the hearing will be in the format of "Witness Name at Page Number." References to the Order will be in the format "Order ¶ X." References to prefiled testimony will be in the format "Witness Name Prefiled at Page Number."

² Rosenbaum at 155.

³ Copeland at 193-194.

⁴ Copeland at 195.

costs, but ultimately results in a model that generally under-distributes support to Qwest and over-distributes support to other companies.

Common sense indicates that the same method and data source should be used to determine costs and to determine support distributions. Qwest asks that the Commission reject the Staff's proposed model, or direct the Staff to revise the model to use the same measure of density for determining both cost and support distributions. This may take additional time, but the added fairness and simplicity that will result is worth the effort.

2. Density Fails To Adequately Explain Cost Differences For Areas Where Most Support Is Targeted.

Perhaps as a byproduct of this unnecessary complexity, or perhaps because of other reasons, for the areas where 98% of support is targeted – areas with zero to seven households per square mile⁵ – insufficient evidence explains the relationship between density and proposed support. In prefiled testimony, and in the attachments to the Order, Staff concluded that there was an R-squared value of 0.95 between cost and density.⁶ Dr. Rosenbaum explained that this means that over the entire distribution of costs and densities observed in the proposed model, 95% of the differences in cost are explained by differences in density.⁷

However, Mr. Copeland focused his analysis on the portion of costs and densities where densities are less than seven households per square mile, because, as noted above, 98% of the fund is distributed to these areas.⁸ For this portion of the

⁵ Order, ¶ 48.

⁶ Order, in attached Distribution Model, sheet titled Reg_Results; Rosenbam at 159-160.

⁷ Rosenbaum at 159-160.

⁸ Copeland Prefiled at 8, lines 1-23.

regression analysis, the R-squared value is only 0.49, which means less than half of the predicted cost can be explained by changes in density.⁹ Dr. Staihr and Mr. Copeland both testified that another factor that could explain differences in cost would be distance.¹⁰

Later in the hearing, Dr. Rosenbaum testified to a new coefficient of determination, or R-squared value, measuring the relationship between cost and density. This new calculation yielded an R-squared value over the entire distribution of 0.78, which means that 78% of the variation in loop costs (again, over the entire distribution, not the portion where 98% of support is targeted) is explained by differences in density.¹¹

These differences are significant. What they tell the Commission is that cost and density are generally related – but the closest relationship between cost and density lies in the areas where only 2% of support is targeted. When examining the relationship between density and cost over the areas where 98% of support is targeted, the proposed model cannot adequately support a relationship between cost and density. As a result, the proposed model, while it may explain the relationship between density and cost in urban Nebraska, does not explain the relationship between density and cost at the levels where almost all of the support would go. Despite this practical problem, Staff proposes that support be based on different densities alone, and fails to account for other variables, like distance, that based on statistical analysis are also primary drivers of cost in areas with very low density.

⁹ Copeland Prefiled, page 8, line 23 – page 9, line 3.

¹⁰ Staihr at 12; Copeland at 208.

¹¹ Rosenbaum at 241-242.

Accordingly, the Commission needs further study before it can conclude that 98% of the support is properly targeted. As with the problem of using two different measures of density, curing this problem may take some time and effort, but will result in more rural Nebraskans getting the support they need for universal service.

Alternatively, instead of varying support in areas of less than seven households per square mile according to density as Staff proposes (such that areas with one household per square mile get more support that areas with six households per square mile), a flat distribution, such that all areas with seven or less households per square mile receive the same amount of support. This would more equitably apportion support in these areas.

Simple Changes To The Transition Model Can Add Predictability And Stability to the NUSF.

Currently, the proposed model includes two key mechanisms that are designed to ease the transition of the NUSF to a cost-based fund: the over-earning redistribution ("OER") and the per-line backstop. The OER takes money from the fund that would otherwise be distributed to carriers but for the fact that those carriers are earning more than 12%. Qwest agrees with Staff and most other parties to this proceeding that the NUSF should provide for reasonable, but not excessive, returns for carriers, and that OER funds should only be provided to carriers that would lose support under the proposed model. However, OER funds are unpredictable. If currently over-earning carriers earn less in the future, there will be less funds to distribute to carriers who lose support under the proposed model. There is no way to adequately predict whether, in any year, any particular carrier will over-earn such that OER funds are available. This

could result in catastrophic reductions in support for Qwest and other carriers whose support is being slashed, despite their compliance with prior directives to reduce access charges in order to obtain NUSF distributions.

A key objective set by the legislature for the NUSF in Neb. Rev. Stat. 86-323(5) is that it be "predictable." Dependence on future over-earnings makes the NUSF unpredictable. The Commission should take steps to make sure that distributions, and the transition mechanism, are predictable.

Staff argues that predictability could be enhanced by removing the OER altogether. This is not feasible, is almost punitive, and would put extreme pressure on carriers like Qwest that are losing support. Alternatively, Staff contends that the per-line backstop offers predictability and stability, because support cannot decrease by more than \$60 per line per year. But the per-line backstop declines so steeply that without reliance on OER funds, Qwest's transition from approximately \$39 million per year in support (\$31 million after porting support to CLECs) would be reduced all the way to approximately \$13 million per year (\$11 million after porting) after only two years. Such a quick reduction in Qwest's support would put incredible pressure on Qwest and its customers.

There is a simpler, more predictable solution – one that would take little effort and time to implement, while not unduly burdening the total fund. Simply set a transition period of seven years. During that seven years, those carriers whose support will increase under the proposed model would receive one seventh of the increase each year. During that same seven-year period, those carriers whose support would

¹² The Order proposed a per-line backstop of \$5 per line per year, but Staff testified that was an error, and should have reflected \$5 per line per month, or \$60 per line per year.

decrease under the proposed model would incur one seventh of the decrease in support each year. The table below (a copy is also attached as Appendix A) shows that such a straight line transition in support not only eases the transition to a cost-based fund, the current fund size could easily support such a plan. The table also shows the fund size required for each year of a five-year transition and a ten-year transition, as well as the fund size required for five, seven and ten year transitions if distributions to areas with seven or less households per square mile were the same, regardless of density in those areas, as Qwest proposes above.

		Transition Dow Immediately U	Transition Both Down and Up				
Year	5 Years	7 Years	10 Years	5 Years	7 Years	10 Years	
1	\$74,385,941	\$76,313,533	\$77,759,227	\$67,897,462	\$69,361,591	\$70,459,688	
_ 2	67,639,369	71,494,553	74,385,941	62,773,009	65,701,268	67,897,462	
3	60,892,796	66,675,573	71,012,655	57,648,557	62,040,944	65,335,235	
4	54,146,224	61,856,592	67,639,369	52,524,104	58,380,621	62,773,009	
5	47,399,652	57,037,612	64,266,082	47,399,652	54.720.298	60,210,783	
6	47,399,652	52,218,632	60,892,796	47,399,652	51,059,975	57,648,557	
7	47,399,652	47,399,652	57,519,510	47,399,652	47,399,652	55,086,330	
8	47,399,652	47,399,652	54,146,224	47,399,652	47.399.652	52,524,104	
9	47,399,652	47,399,652	50,772,938	47,399,652	47,399,652	49,961,878	
10	47,399,652	47,399,652	47,399,652	47,399,652	47,399,652	47,399,652	

	Uniform Distribution for Areas Between 0 and 7 Households Per Square Mile											
		「ransition Dow Immediately Up	Transition Both Down and Up									
Year	5 Years	7 Years	10 Years	5 Years	7 Years	10 Years						
1	\$71,750,111	\$73,693,707	\$75,151,404	\$67,325,485	\$68,953,036	\$70,173,699						
2	64,947,525	68,834,717	71,750,111	61,629,055	64,884,158	67,325,485						
3	58,144,939	63,975,727	68,348,818	55,932,626	60,815,280	64,477,270						
4	51,342,353	59,116,737	64,947,525	50,236,196	56,746,401	61,629,055						
5	44,539,767	54,257,747	61,546,232	44,539,767	52,677,523	58,780,840						
6	44,539,767	49,398,757	58,144,939	44,539,767	48,608,645	55,932,626						
7	44,539,767	44,539,767	54,743,646	44,539,767	44,539,767	53,084,411						
8	44,539,767	44,539,767	51,342,353	44,539,767	44,539,767	50,236,196						
9	44,539,767	44,539,767	47,941,060	44,539,767	44,539,767	47,387,982						
10	44,539,767	44,539,767	44,539,767	44,539,767	44,539,767	44,539,767						
TOTAL	\$513,423,529	\$547,436,459	\$598,455,854	\$502,361,963	\$530,844,110	\$573,567,331						

Any of the transition scenarios in the above tables would provide greater stability and predictability to the fund. All of them would result in a simpler distribution scheme during the transition period that would be easier to administer. All are achievable with the current funds available to the NUSF, particularly if both carriers with increasing and decreasing support transition to new levels over time. And all are fair to every carrier, regardless of size. Since each carrier would lose (or gain) the same percentage of the change in support, all carriers would be treated the same, regardless of size. Qwest requests that the Commission implement one of these transition plans.

Proposal 1 For Porting Support to Competitive NETCs Is The Only Acceptable Alternative.

Staff discussed three different proposals¹³ for porting support to competitive NETCs that gain lines as a result of competition, so that these competitors would gain the same support, on a per line basis, as ILECs receive for the lines they serve, and so that ILECs would lose support for lines they no longer serve. The first proposal would continue the procedure now in place. That procedure ports support to competitive NETCs averaged in the same manner as de-averaged UNE-loop rates in the respective support area.¹⁴

The second proposal would charge a competitive NETC the UNE-loop rates for zone 1 (\$12.14, the lowest-priced zone, relating to larger cities) for all three UNE zones in Nebraska, instead of the Commission-approved price for zone 2 (\$28.11) or zone 3 (\$62.50). Competitive carriers that are not NETCs would continue to be charged the applicable zone rate. Qwest would then keep all support for the lost line. This proposal has several problems. First, it would violate 47 CFR 507(f), which requires at least three different zones and that the rates for each zone be based on TELRIC principles.

Second, the second proposal would cost Qwest \$7 million per year in lost revenue from UNE-loops. Particularly given the fact that Qwest would lose approximately \$20 million per year in support in the transition to a cost-based fund, this is unconscionable. Qwest should not be called upon to support the NUSF or to support its competitors.

 $^{^{13}}$ Staff does not recommend any of the three alternatives, but merely presents them as options for the Commission to consider. *E.g.*, Pursley at 261-262.

¹⁴ Order, ¶ 21.

Third, the second proposal would distort the incentives for NETCs to serve areas in zones 2 and 3, as Dr. Staihr observed. ¹⁵ Charging artificially lower rates in zones 2 and 3 would improperly give CLECs incentives and competitive advantages to serve zones 2 and 3.

Fourth, the second proposal is not competitively neutral. There were many examples and much discussions surrounding this point at the hearing, but all those discussions boil down to one point: The only way proposal 2 could be competitively neutral is if the difference between UNE-loop prices in zones 2 and 3 and zone 1 prices are the same as the support, on average, that Qwest would receive for those areas under the proposed model. If the support Qwest would retain under proposal 2 were greater than the discount competitive NETCs would receive, then Qwest would obtain a competitive advantage. If Qwest's support under the proposed model were less than the NETC's discount, the NETCs would gain a competitive advantage. There is no evidence whether or not the difference between the prices for zones 2 and 3 and zone 1 is an effective surrogate for the support Qwest would receive for a line lost to competition. As a result, the simplest and most straightforward solution would be to assign the same support, on average, on a per-line basis, to both incumbent carriers and competitive NETCs. That is precisely what proposal 1 does, and that proposal should be adopted.

¹⁵ Staihr Prefiled page 5, line 3 – page 6, line 10; Staihr 9-10.

¹⁶ Another competitive distortion results from proposal 2 (and proposal 3) because among Nebraska's incumbent carriers, only Qwest and Alltel have obligations to interconnect and provide UNE-loops to competitors. Other incumbents are not subject to these obligations because of the rural exemption. This exacerbates the competitive distortions caused by proposals 2 and 3.

¹⁷ Mr. Pursley indicated on cross-examination that this could be a "potential issue," Pursley at 68, but also indicated that Staff had not done analysis to determine whether the difference between the prices for zones 2 and 3 and zone 1 was as much as, greater than, or less than what Qwest would get on average in those areas. Pursley at 60.

Proposal 3 is almost identical to proposal 2, with two practical differences: Qwest would not be forced to contribute \$7 million towards the competitive and universal service efforts of competitive NETCs, because proposal 3 would provide support to competitive NETCs in the amount of the difference between the zone 2 and zone 3 prices and the zone 1 price. Instead, this amount would come from the fund, potentially placing additional burdens on already insufficient resources. Second, proposal 3 would eliminate the problem of compliance with federal regulations requiring Qwest to charge TELRIC-based prices across all three zones. However, the market distortions and competitive disadvantages are the same in both proposals 2 and 3. Proposal 1 does not suffer from these defects and should be adopted.

Conclusion

The Commission's analysis of NUSF-26 should begin with three facts. First, the fund is limited. Second, the fund, even according to Staff's own model, is insufficient to provide all carriers with all the support they need to provide basic services in rural Nebraska. 18 Third, many carriers will lose a substantial amount of support – particularly those like Qwest, who did what the Commission asked them to in C-1628 and reduced access charges.

With these three facts in mind, the Commission must carefully consider any changes it makes to the fund, and carefully consider the impacts those changes will have on different carriers and their customers. Drastically reduced and insufficient support puts pressure on carriers like Qwest to raise prices for service and switched

QWEST CORPORATION'S COMMENTS TO PROGRESSION ORDER NO. 5. -- Page 12 of 14

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¹⁸ The Staff's model reveals that in order to fund all the low cost areas for which it determined costs, the fund would need to be approximately \$228 million. There was much debate as to whether this amount was the proper measure, but even if total required costs were half this amount, the current fund size would still fall woefully short of providing all carriers the support they need.

access charges. 19 The problems with the proposed model that Qwest has pointed out

in its comments and testimony throughout this proceeding are serious, and require

careful deliberation. At the end of the day, however, Qwest's proposals are simpler and

fairer than the currently proposed model, while placing few additional burdens on the

available funds for distribution. Qwest respectfully requests that the Commission adopt

Qwest's proposals - even if they involve taking additional time and effort to make sure

distributions are fair and are based on rational relationships between costs and the

drivers of those costs, like density and distance - and provide all Nebraskans with the

best universal service fund possible.

Dated Thursday, September 30, 2004

19 Qwest prehearing Comments, at 2;

QWEST CORPORATION

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 30th day of September, 2004 an original and six copies with an electronic copy of Qwest Corporation's filing in Application No. NUSF-26, were couriered to:

Mr. Andrew Pollock Executive Director Nebraska Public Service Commission 1200 N Street 300 The Atrium Lincoln, NE 68509-4927

and that a true and correct copy of the above and foregoing was sent via United States first-class mail, postage prepaid, this Z day of September, 2004 to the following:

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Ву

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SUPPORT TRANSITION SUMMARY

TOTAL	0.1	, _e	> >	7	6	. Un	4 :		, ,)	Year		
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62,240	99,652	47,399,652	47,399,652			47,399,652	54,146,224			74,385,941			taff's Pr
\$ 575,195,102	\$ 47,399,652	\$ 47,399,652 \$	\$ 47,399,652 \$	\$ 47,399,652	\$ 52,218,632	\$ 57,037,612 \$	\$ 61,856,592	\$ 66,675,573		\$ 76,313,533	/ Years	Transition Down Immediately Up	oposed Distribu
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TOTAL \$ 541,462,240 \$ 575,195,102 \$ 625,794,394 \$ 525,241,042 \$ 550,863,305 \$ 589,296,698	\$ 47,399,652 \$ 47,399,652 \$ 47,399,652	\$ 47,399,652				\$ 47,399,652 \$	\$ 52,524,104 \$		62,773,009		5 Years	Transit	Staff's Proposed Distribution for Areas Between 0 and 7 Households Per Square Mile
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\$ 598,455,854	\$ 44,539,767	44,539,767 \$ 47,941,060 \$	44,539,767 \$ 51,342,353	\$ 54,743,646 \$	49,398,757 \$ 58,144,939 \$	54,257,747 8 61,546,232	64,947,525	63,975,727 \$ 68,348,818 \$	\$ 71,750,111	\$ 75,151,404	10 Years	Variable Annual Property Annua	for Areas Betwe
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547,436,459 \$ 598,455,854 \$ 502,361,963 \$ 530,844,110 \$ 573,567,331	44,539,767 S 44,539,767 S 44,539,767 S 44,539,767	\$ 44,539,767 \$	44,539,767 \$ 44,539,767 \$ 50,236,196	\$ 44,539,767		\$ 52,677,523 \$	\$ 56,746,401	\$ 60,815,280 \$	\$ 64,884,158 \$	73,693,707 \$ 75,151,404 \$ 67,325,485 \$ 68,953,036 \$ 70,173,699	7 Years	Transition Both Down and Up	Uniform Distribution for Areas Between 0 and 7 Households Per Square Mile
\$ 573,567,331	\$ 44,539,767	\$ 47,387,982	\$ 50,236,196			\$ 58,780,840	56,746,401 \$ 61,629,055	\$ 64,477,270	\$ 67,325,485	\$ 70,173,699	10 Years	and Up	Mile

APPENDIX A